



Multistate Tax Commission Memorandum

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To: Wood Miller, Chair
Members of the Income & Franchise Tax Uniformity Subcommittee

From: Shirley Sicilian

Date: August 3, 2006

Subject: Special Rule for Telecommunications Apportionment

I. Background

At its prior meetings, the Income & Franchise Tax Uniformity Subcommittee determined: 1) there are problems with the application of UDITPA §17 to entities engaged in the sale of telecommunications and ancillary services, 2) the problems are best addressed by a special apportionment rule with sales factor sourcing based primarily on service address, and 3) a special apportionment rule which closely follows the language of the Streamlined Sales & Use Tax Agreement (SS&UTA) will effectively source sales receipts to service address.

At its last meeting in March, 2006, the Subcommittee reviewed a draft model regulation based closely on SS&UTA language and identified two issues. First, receipts from ancillary services should be source similarly to those from prepaid calling service or prepaid wireless calling service, rather than similarly to telecommunications services.¹ The attached draft reflects this change. (Attachment A)

The second issue is that there are no specific SS&UT rules for sourcing receipts from telecommunication services that are sold for resale or sold as inputs to other services.² Perhaps this is because these types of services are often not subject to sales tax, and thus not at issue for SS&UTA purposes. Nonetheless, we must develop sourcing rules for receipts of these services for income tax purposes. The Subcommittee identified a handful of sourcing options and requested industry data that might shed some light on the magnitude of the issue. The remainder of this memo sets out the requested revenue data and sourcing options related to telecommunication input and wholesale services.

II. Telecommunication Input and Wholesale Service Revenue Data

A rough estimate using data from the U.S. Census Bureau 2006 Statistical Abstract suggest telecommunication input and wholesale service revenue (carrier services and other telecommunication services, less internet access service and plus dedicated network

¹ This change mirrors the SS&UTA which sources prepaid calling service, prepaid wireless calling service and ancillary services under section 310 (general sourcing rules), rather than under section 314 (telecommunication sourcing rule).

² Nor are these types of services included in the definitions section of the SS&UTA.

service) may have decreased 7% from 2001 to 2004, but comprised over 20% of total telecommunication revenue in both years. (See the following Tables and Chart.)

III. Possible Telecommunication Input and Wholesale Service Sourcing Options

A. Place of Primary Use – With or Without a “Look Through” to the Ultimate Consumer

Under the current draft regulation, if receipts from telecommunication input and wholesale services are not specifically provided for, these receipts will be sourced under the general provisions to “place of primary use.” “Place of primary use” is defined as “the street address representative of where the customer’s use of the telecommunications service primarily occurs, which must be the residential street address or the primary business street address of the customer...” It is not clear what the “place of primary use” is for telecommunication input or wholesale services. For example, there isn’t necessarily one single address where telecommunication internet backbone services are “used” by the purchaser, the Internet Service Provider. “Place of primary use” could refer to the ISP’s business address. Or, it could refer to the ISP’s *customer’s* home or business address.

There is precedent for the latter approach in MTC Regulation IV.18.(h): Special Rule for Television and Radio Broadcasters. Under that special rule, the sales factor numerator is sourced to a state based on an “audience factor.” The audience factor is the ratio that the taxpayer’s in-state viewing (listening) audience bears to its total viewing (listening) audience (MTC Reg. IV.18 (h)(4)(iv)B.2. and B.3.). This approach “looks through” the broadcaster to the broadcaster’s audience’s location.

B. Throw-Out

Another possible approach would be to simply exclude these receipts from the sales factor numerator and denominator. This option may be reasonable if the receipts from these services are not significant relative to total receipts. The special regulation for television and radio broadcasters also provides precedent for this approach in its throwout of outer-jurisdictional property from the property factor numerator and denominator (MTC Reg. IV.18 (h)(4)(ii)B.3. and C.2). MTC Regulation IV.18.(c)(3) is another example of the use of throwout where the location of the receipts cannot readily be determined:

Where business income from intangible property cannot readily be attributed to any particular income producing activity of the taxpayer, the income cannot be assigned to the numerator of the sales factor for any state and shall be excluded from the denominator of the sales factor.

MTC Reg. IV.18(c)(3)2nd Paragraph.

C. Limited, Customized Cost of Performance

Another option would be to retain a cost of performance approach for telecommunication input and wholesale services, but to clarify its application to these particular services.

IV. Possible Next Steps

A. Special Rule or General Revisions to UDITPA §17?

The premise for development of this special rule has been that there are problems with the application of UDITPA §17 in sourcing receipts from telecommunication and ancillary services. In May of 2006, the MTC Executive Committee directed the development of proposed amendments to UDITPA §17. The purpose of the proposed amendments is to address many of the same problems we are attempting to solve here – and, in the absence of a special regulation for telecommunications and ancillary services under UDITPA §18, the amendments would apply to these services. The Subcommittee should consider whether to continue developing the special regulation pursuant to UDITPA §18 in light of the plans to propose amendments to the general rule of UDITPA §17. Timing may be a consideration. Although development of this special rule has been a very long process, it is fairly far along at this point. Proposed amendments to UDITPA §17 could take just as long, and that process is just getting started.

If the Subcommittee would like to continue development of the special rule, then it should consider forming a drafting group to address the telecommunication input and wholesale service issues described above. The Subcommittee may also wish to consider an invitation from Deborah Bierbaum, AT&T, to tour the AT&T Technology Center in Washington, D.C. during our November meetings.

Telecommunications - Estimated Revenue for Employer Firms, 2001 - 2004

	2004	% of Total	2001	% of Total	% Change 2004/2001
TOTAL	356,114		365,835		-3%
Fixed	136,002	38%	178,160	49%	-24%
Mobile	111,450	31%	77,994	21%	43%
Carrier Services	59,792	17%	63,252	17%	-5%
Other Telecommunications Services	14,440	4%	14,989	4%	-4%
Other Service Revenue	34,430	10%	31,440	9%	10%
Carrier and Other Telecom Services Less Internet Access Service Plus Dedicated network Services	79,415	22%	85,531	23%	-7%

Fixed	Mobile	Carrier Services
Fixed Local	Mobile Telephony Services	Network Access
Basic Service	Local Access and Use	Other Carrier Services
	Mobile Value-added	
Fixed Value-added Service	Services	
Fixed Long Distance	Mobile Long Distance	Other Telecommunications Services
Outbound Service	Mobile All Distance	Internet Backbone Services
Inbound Service	Dedicated Network Services	Internet Access Services
Fixed All Distance	Other Mobile Telephony Revenue	Multichannel Programming Distribution Services
Dedicated Network Service	Messaging Services	Other Telecommunications Related Services
Data Transmission Service	Mobile Dispatch Service	

Other Services Revenue
Telecommunications Network Installation Services
Telecommunications Equipment Sales
Telecommunications Equipment Rental
Telecommunications Equipment Maintenance
Network Design and Development Services, Other Than Security
Sales of Directory Advertising Space
Rental or Sale of Mailing Lists
Other Revenue

Source: U.S. Census Bureau; 2006 Statistical Abstract; Telecommunications (NAICS 5133)

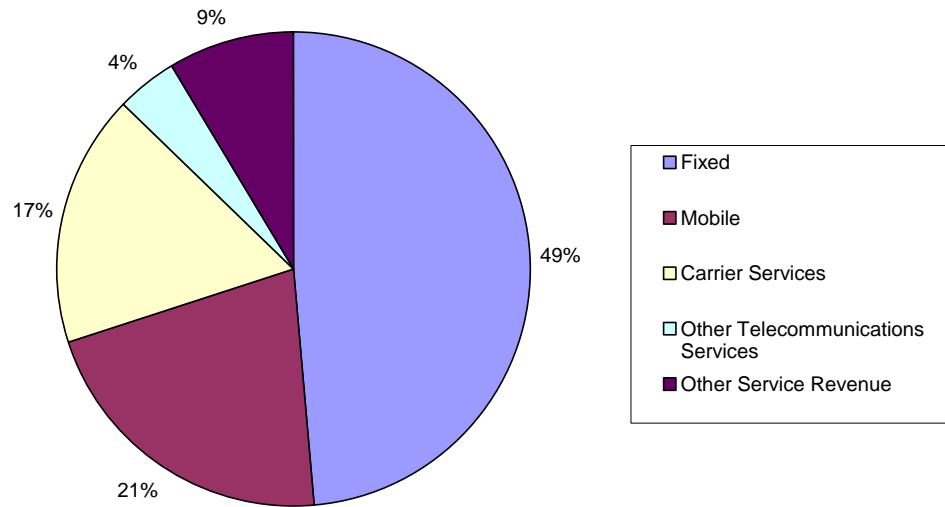
Table 3.3.8. Telecommunications (NAICS 5133)—Estimated Revenue and Expenses for Employer Firms: 2001 Through 2004

[Estimates are based on data from the 2004 Service Annual Survey and administrative data. Estimates for 2003 and prior years have been revised to reflect historical corrections to individual responses. Dollar volume estimates are published in millions of dollars; consequently, results may not be additive. Estimates have been adjusted using results of the 2002 Economic Census]

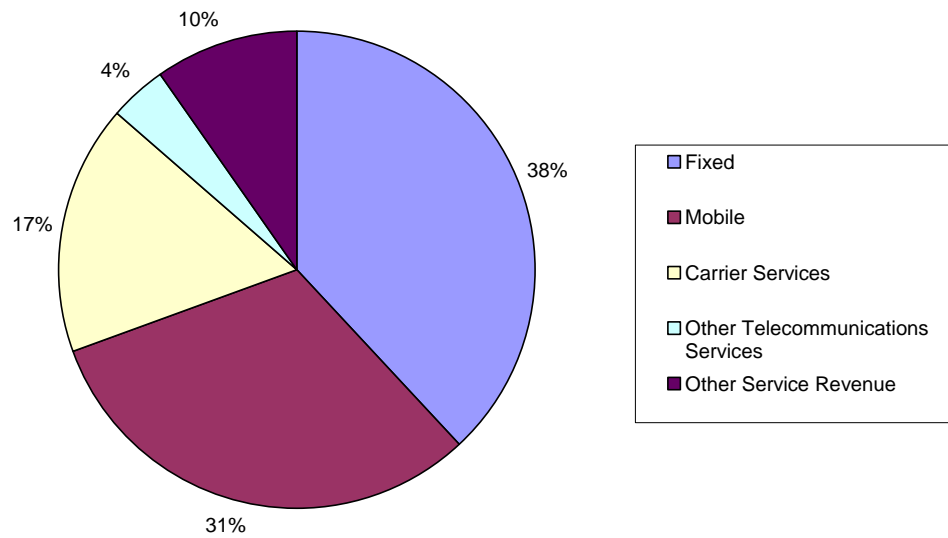
Item	2004	2003	2002	2001	Percent change		
					2004/2003	2003/2002	2002/2001
OPERATING REVENUE							
Total	356,113	350,976	353,936	365,836	1.5	-0.8	-3.3
Fixed total	136,002	147,534	162,135	178,160	-7.8	-9.0	-9.0
Fixed local	73,928	75,021	80,148	84,533	-1.5	-6.4	-5.2
Basic service	61,093	62,687	66,905	69,770	-2.5	-6.3	-4.1
Fixed value-added services	12,835	12,334	13,243	14,763	4.1	-6.9	-10.3
Fixed long-distance	40,280	48,240	55,843	65,665	-16.5	-13.6	-15.0
Outbound service	33,987	39,640	44,938	53,056	-14.3	-11.8	-15.3
Inbound service	6,293	8,601	10,905	12,609	-26.8	-21.1	-13.5
Fixed all distance	3,434	S	3,915	4,694	S	S	-16.6
Dedicated network services	9,525	10,493	11,702	12,207	-9.2	-10.3	-4.1
Data transmission services	8,835	9,816	10,526	11,060	-10.0	-6.7	-4.8
Mobile total	111,450	99,672	89,690	77,994	11.8	11.1	15.0
Mobile telephony services	108,401	96,142	85,728	73,103	12.8	12.1	17.3
Local access and use	81,273	73,469	63,204	52,713	10.6	16.2	19.9
Mobile value-added services	4,294	3,410	2,945	2,400	25.9	15.8	22.7
Mobile long-distance	7,139	5,424	6,134	5,192	31.6	-11.6	18.2
Mobile all distance	13,075	11,604	11,252	9,694	12.7	3.1	16.1
Dedicated network services	S	S	S	S	S	S	S
Other mobile telephony revenue	2,610	S	2,175	3,073	S	S	-29.2
Messaging services	2,366	2,771	3,259	4,393	-14.6	-15.0	-25.8
Mobile dispatch services	683	S	S	S	S	S	S
Carrier services	59,792	59,212	60,506	63,252	1.0	-2.1	-4.3
Network access	53,768	53,349	54,614	55,781	0.8	-2.3	-2.1
Other carrier services	6,024	5,863	5,892	7,471	2.7	-0.5	-21.1
Other telecommunications services	14,440	14,448	14,436	14,989	-0.1	0.1	-3.7
Internet backbone services	1,545	1,721	1,895	2,293	-10.2	-9.2	-17.4
Internet access services	4,342	4,329	4,343	4,917	0.3	-0.3	-11.7
Multichannel programming distribution services	S	S	S	S	S	S	S
Other telecommunications related services	7,952	7,607	7,408	7,179	4.5	2.7	3.2
Other services revenue	34,430	30,110	27,169	31,440	14.4	10.8	-13.6
Telecommunications network installation services	2,609	2,002	1,716	2,744	30.4	16.6	-37.5
Telecommunications equipment sales ...	12,321	9,775	8,978	8,583	26.0	8.9	4.6
Telecommunications equipment rental ...	1,016	1,002	1,150	1,130	1.5	-12.9	1.8
Telecommunications equipment maintenance	666	869	919	839	-23.4	-5.5	9.5
Network design and development services, other than security	S	S	S	156	S	S	S
Sales of directory advertising space	1,017	1,054	1,151	1,265	-3.5	-8.5	-9.0
Rental or sale of mailing lists	S	S	S	S	S	S	S
Other revenue	16,658	15,246	13,113	16,722	9.3	16.3	-21.6

See footnotes at end of table.

**2001 Estimated Telecommunications Revenue
Percent of Total**



**2004 Estimated Telecommunications Revenue
Percent of Total**



Source: U.S. Census Bureau 2006 Statistical Abstract